July 14, 2016

Dear Clients, Partners, and Friends,

The results for South Ocean Management's Delaware LP, Hong Kong Partners' L.P., before incentive fees, were as follows:

	Jun 2016	Year-to-date
Hong Kong Partners LP	- 4.3%	-6.6%
Hang Seng Index	-0.1%	-5.1%
Hang Seng Small Cap Index	-1.7%	-12.1%

Partners' NAV $2.8090 after management fee and provisions, but before annual incentive fees of 15% on appreciation.

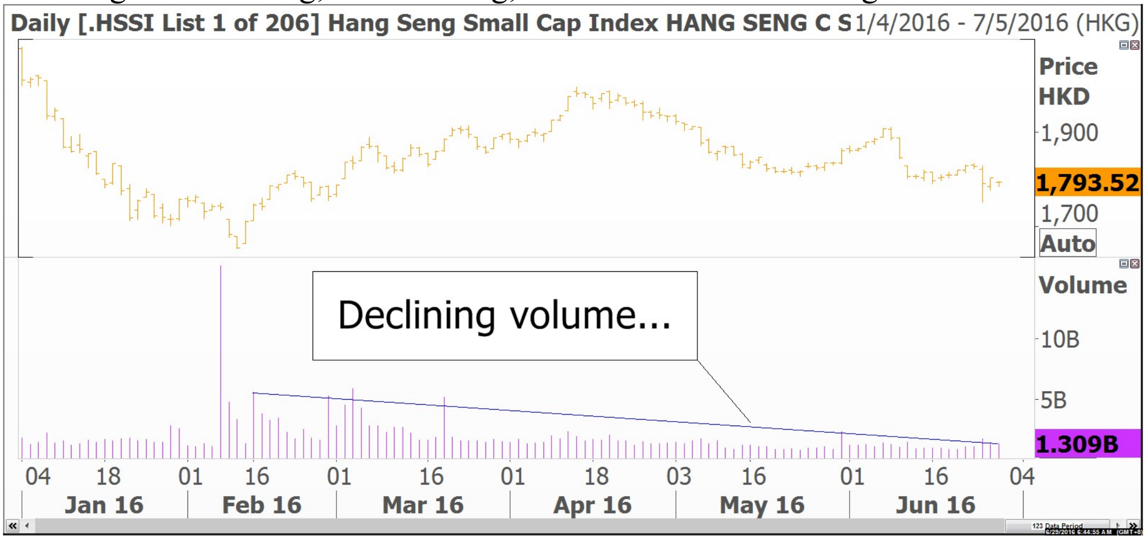
South Ocean Management's mandate of owning quality small/mid cap stocks, with operations benefiting from growth in China, has not changed since we launched our operations in Hong Kong in 1993. We concentrate our investing in non-index, primarily out-of-favor stocks, using our proprietary software screen (which is not a 'black box') to select and build these positions in our portfolios, before they become market favorites.

Our discipline is to screen, evaluate and own fundamentally strong businesses of companies listed in Hong Kong. We determine a future intrinsic value for each company (based on a reasonable 5 to 10-year earnings per share growth rate) and a maximum price to buy.

In review of what has transpired this year, the first six months of 2016 were notably unstable for all stock markets. Global political/economic uncertainties and volatile stock markets shook equity investors in the first half of 2016. January and February started the year with a global stock market sell-off on concerns of higher interest rates, Yuan depreciation fears and collapsing oil prices. Markets then staged an abrupt about-face and rallied into April (on hopes of more Central Banks' stimulus).

The month of May saw cautious sentiment building into June, which began with a steep Hong Kong market sell off on accelerating concerns of worldwide economic slowdown and the rising risks from the UK's possible exit from the European Union. June culminated with the global market panic on the Brexit leave vote. (As an aside, for China, the world's largest exporting country, at US$2.27 trillion 2015, the UK only accounts for a 2% share).

These concerns weighed on Hong Kong stocks as the blue chip Hang Seng Index declined 5% for the first half. Hong Kong small/mid cap equity investors kept watching and watching, not investing, amid much slower trading:



The sector has been off-the-radar this year, but there were pockets of positive activity.

As one example, in the past quarter, we took partial profits in one of our best performing, top 10 holdings after an 80+% gain from our initial cost, reclining chair and sofa manufacturer, Man Wah Holdings (code 1999HK, 4.3% holding, market cap HK$20.8bn, US$2.7bn). Man Wah reported that profit attributable to owners of the company for the year ended March 31, 2016 increased 24.3% to HK$1.33 billion.

The company is the number three market leader in the US reclining chair market (after Lazy Boy and Ashley Furniture) and is experiencing fast growth in China sales. Under its brand 'Cheers', Man Wah is the largest recliner sofa manufacturer in China, with a dominant market share of 29.5% in 2015. Its shares sell at 15 times 2016 estimated earnings (March 2017 fiscal year), 13.6 times 2017 estimates. The outlook for furniture sales in China is quite positive, with 6 million new homes expected to be built annually for the next 10 years.

Our overall results in June were burdened by 1), a reported earnings decline in a long time holding (retailer and textile producer, Texwinca Holdings, code 321HK, market cap HK$7.8billion, US$1.1bn, 4.3% holding) and 2), selling pressure with two large holdings (Tongda Group, code 698HK, 9.0% holding and Beijing Enterprise Water Group, code 371HK, 6.2% holding).

Texwinca's textile sales, particularly to USA retail merchants in the second half (fiscal year ends in March), were unexpectantly weak. The company's retailing division, Baleno, as hoped for, turned around and broke even after years of declining sales in China. Yet, as US retailers struggle, the company warned of a ‘challenging’ outlook for the rest of the year. The surprising weakness, (despite subdued cotton prices and generally strong business conditions the past two years), caught the market (and us) off guard. We exited the entire position, for a slight long term profit.

At current levels, both Tongda Holdings and Beijing Enterprise Water Holdings share prices are unduly depressed.

Our overall portfolio sells at a low 7 times estimated P/E. Valuations of our top holdings are not excessive and on a two-year time horizon, we are quite optimistic.

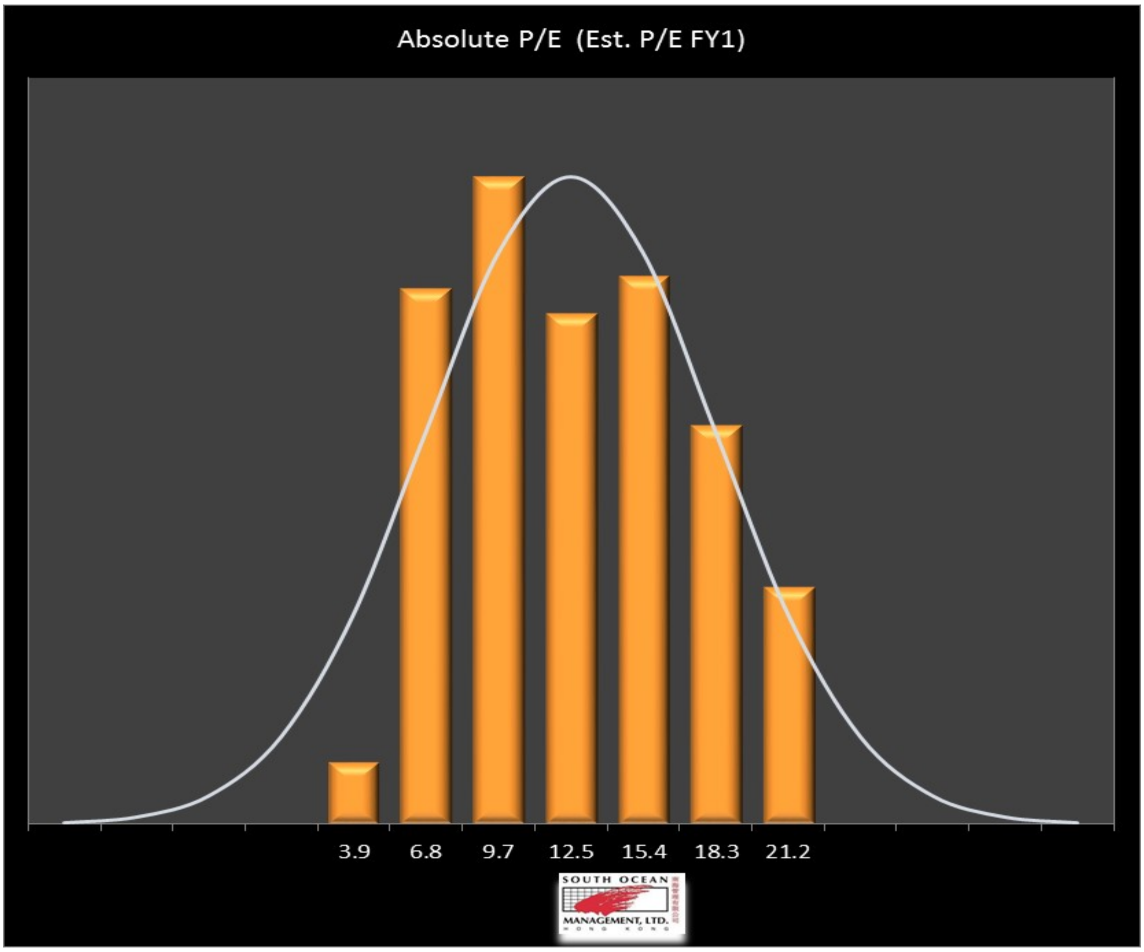
Though this year has been challenging, we have been through many of these quiet trading cycles in Hong Kong before and tend to do quite well at the other end of the cycle when we hold quality equities.

Our contrarian bullishness is based on the risk/gain ratios, on a relative and absolute basis. These are Reuters’ estimates for the US and Hong Kong indexes:

	Est P/E	
	2016	2017
S&P 500	17.4	15.7
Hang Seng	11.5	10.4
HK Partners	7.5	6.2

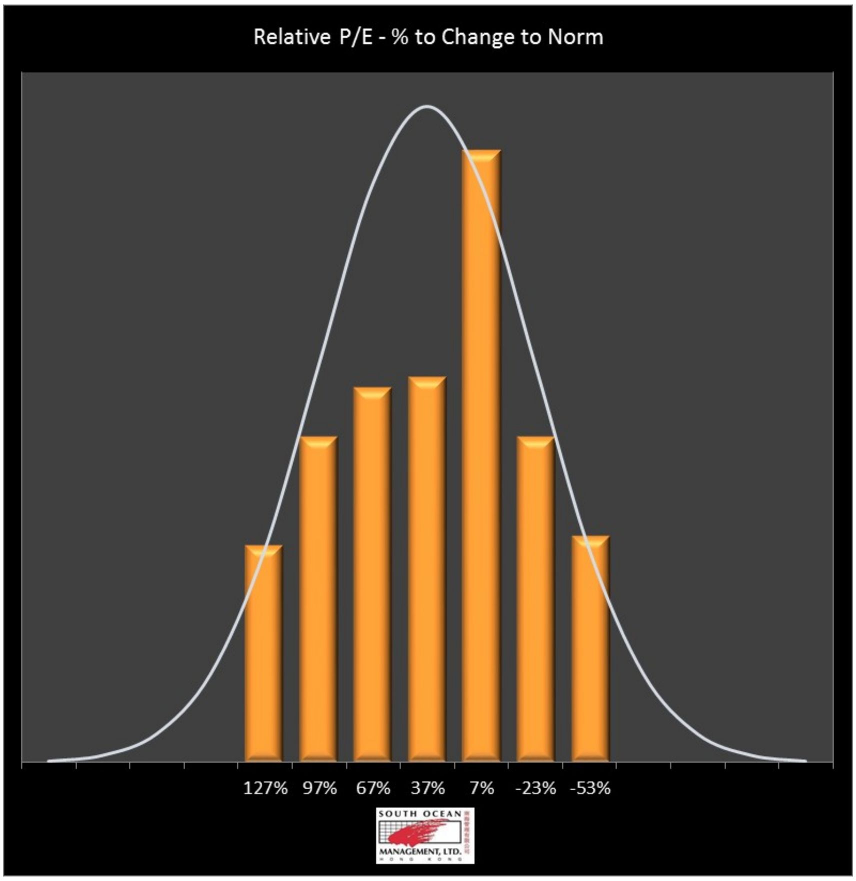
We have noted several times this year the relative attractiveness of values in Hong Kong versus the US.

The following chart of the Hang Seng Composite Index (~500 top capitalized stocks), shows stocks sell at an average 12.5 times this year’s projected earnings;

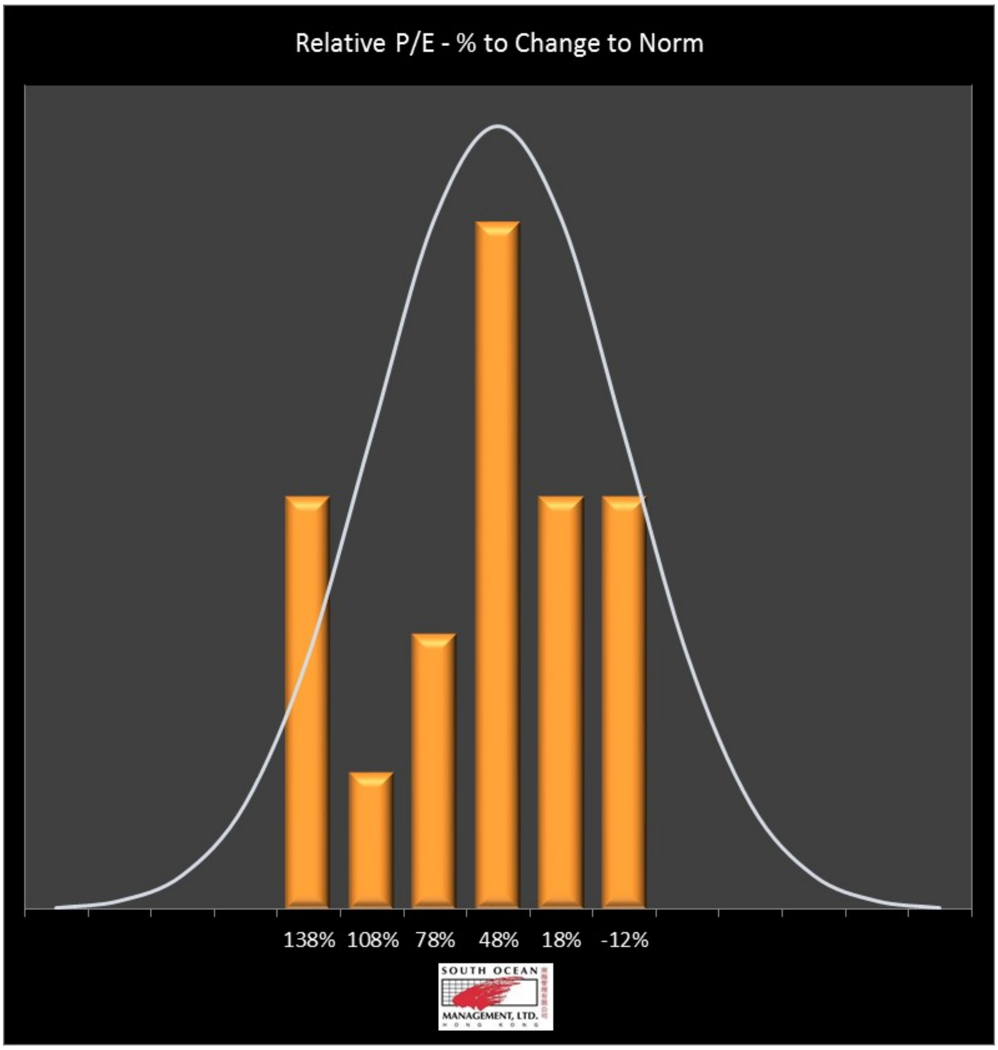


This is not an expensive market, and there are many stocks that sell below the average.

On a relative basis, if stocks in the index were to sell at their 10-year average P/E multiples, on projected earnings, the typical stock would increase 37%;



Our concentrated portfolio, using the above metrics of 10-year average P/E multiple on this year's consensus earnings, has the following characteristics:



Applying our Banquet System, intrinsic value model, most of our holdings today are within our maximum price to buy range.

With stocks cheap, on a relative and absolute basis, any inkling of positive news emanating from China (on economic/profit growth prospects, reforms, currency stability) could easily catapult share prices higher. We wait patiently.

Sincerely,

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